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C O N F I D E N T I A L SECTION 01 OF 05 ROME 000834

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BRUSSELS PLEASE PASS TO EUR DAS MATTHEW BRYZA

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TAGS: [ECON](#) [ENRG](#) [EPET](#) [ETRD](#) [IT](#)

SUBJECT: SCENESETTER FOR EUR DAS BRYZA'S MARCH 17 VISIT TO
ROME: A PRIMER ON ITALIAN ENERGY POLICY

REF: A. ROME 338

[B](#). ROME 324

[C](#). 05 ROME 4155

[D](#). 05 ROME 1995

[E](#). 05 ROME 1807

SUMMARY

[1](#). (C) Embassy Rome welcomes the visit of EUR DAS Matthew Bryza to Rome March 17. DAS Bryza's visit comes in the midst of a natural gas shortage here in Italy that has caused gas delivery interruptions to industrial customers and highlighted the inadequacies of Italy's energy infrastructure; and at a time when Italian electricity giant ENEL's proposed merger with France's Suez electricity company illuminates the transnational nature of the energy business. Embassy views DAS Bryza's visit as an excellent opportunity to (i) solicit GOI views on energy security, including Italy's heavy dependence on Russian oil and gas; (ii) brief the GOI on our Eurasian Natural Gas Strategy; and (iii) solicit GOI views on the Turkey-Greece-Italy natural gas interconnector.

[2](#). (U) On the issue of energy security, the GOI does not view drops in Russian natural gas imports this winter as the cause of the current critical natural gas shortage. Rather, our contacts blame the very high natural gas demand on an unusually cold winter, the resulting increase in fuel needs for gas-fired power plants, and the inadequate capacity of the underlying gas infrastructure. GOI energy experts will probably try to convince DAS Bryza that Italy's energy security is best assured by increasing the routes through which Italy can access Russian gas supplies. End summary.

ENERGY SOURCES

Natural Gas

[3](#). (U) Italy is one of the EU's largest natural gas consumers. According to Sergio Garribba, Director General for Energy at the Ministry for Productive Activities (MPA), Italy uses an average of 8.8 billion cubic feet (250 million cubic meters) of natural gas daily, primarily for electricity production and heating. This figure is lower in the summer and rises in the winter due to increased demand for residential heating.

¶4. (U) Italy uses natural gas to produce 43 percent of its electricity. Natural gas-fired electricity plants with a capacity of 24,000 megawatt hours are either completed or at some stage of construction. When all new plants come on-line, Italy's gas-fired electricity-generating capacity will be Europe's highest. Garribba predicts that at the current rate of expansion, 70 percent of Italy's electricity will be generated using natural gas by 2015.

¶5. (U) In the past two years, approximately one million additional Italians have begun using natural gas for residential heating. In 2004, Italy imported 2.8 trillion cubic feet of natural gas, a 7.4 percent increase over the previous year. The addition of retail natural gas customers and natural gas-fired power plants guarantees that future demand will equal or surpass the seven percent increase which occurred between 2003-2004.

¶6. (U) Italy has proven natural gas reserves of approximately eight trillion cubic feet and meets about twelve percent of its demand through domestic production of 1.1 billion cubic feet (31 million cubic meters) a day. Italy relies on imported gas for the remainder of its needs. Italy imports 2.1 billion cubic feet (60 million cubic meters) of natural gas, or 30 percent of its daily needs, from Russia, with the remainder of its supply coming from Algeria (30 percent) and Libya and the North Sea (30 percent). Italy could increase domestic production by drilling near Venice, but proposals to open off-shore drilling near Venice have been blocked over concerns that natural gas extraction could speed the rate at which Venice is sinking.

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¶7. (U) Italy's domestic natural gas transmission system is Europe's third-largest, and includes 19,000 miles of pipelines carrying 2.7 trillion cubic feet of natural gas annually. (These figures exclude international pipelines feeding into Italy's domestic pipeline system.) Italy imports natural gas from Algeria through the Trans-Mediterranean pipeline, which has a capacity of 2.332 billion cubic feet per day. ENI, the pipeline's operator, plans to increase the Transmed pipeline's capacity to 3.48 billion cubic feet per day. Imports from the North Sea come via the Trans-European Pipeline, while the Trans-Austrian Pipeline delivers Russian gas. Finally, the "Greenstream" Pipeline, majority-owned by Eni, connects Italy to the Western Libya Gas Project. When fully operational, Greenstream will transport 282 billion cubic feet (eight billion cubic meters) of Libyan gas to Europe annually, of which Eni's stake is 141 billion cubic feet (four billion cubic meters).

¶8. (U) Sonatrach (Algeria), Enel (Italy) and Wintershall (Germany) plan to build an additional pipeline from Algeria to Sardinia (and then to continental Italy). Construction will cost roughly two billion euros and will conclude in ¶2008. Similarly, a Turkey-Greece-Italy Inter-connector (TGI) pipeline is under construction.

¶9. (U) Efforts to increase Italy's liquefied natural gas (LNG) use have been slowed by local opposition and environmental concerns. Italy has only one operating re-gasification plant that produces 190 million cubic feet of gas daily, but several planned or under construction. ExxonMobil owns 45 percent of a re-gasification plant under construction near Rovigo, on the northern Adriatic, with a capacity of 770 million cubic feet daily when completed in ¶2007. Similarly, British Gas and Enel, the Italian electricity parastatal, are building a re-gasification facility near Brindisi with a daily capacity of 770 million cubic feet. ERG and Royal Dutch Shell also plan to build a re-gasification facility in Sicily. Finally, the Offshore LNG Terminal (OLT) consortium has received permission to

construct an offshore facility with a daily capacity of 290 million cubic feet near Livorno, on Italy's west coast.

Oil/Petroleum

¶10. (U) In 2005, Italy consumed an average of 1.8 million barrels of oil daily, of which 1.7 million barrels was imported. Italy's increased use of natural gas for heating has caused oil imports to drop marginally, but has not yielded dramatic results.

¶11. (U) Roughly fifteen percent of Italy's electricity is generated using oil. Italy also imports oil for use in residential heating, industrial processes, and to refine into petroleum products, including gasoline. OPEC provides 57 percent of Italy's total oil imports, including Libya (24.87 percent), Saudi Arabia (10.85 percent), Iran (8.74 percent), Algeria (6.45 percent), Iraq (3.78 percent), Nigeria (1.34 percent), Venezuela (0.64 percent), and Indonesia (0.33 percent). Non-OPEC countries, including Russia, provide the remaining 43 percent of oil imports. Italy has an advantage over other oil consumers, in that it is efficient in refining heavy oil such as that from Saudi Arabia. The GOI wants to provide incentives for companies to retain this refining capability because it enables Italy to buy cheaper heavy oil as opposed to more expensive light crude.

¶12. (U) Italy is Iran's largest EU trading partner. Italian oil and gas parastatal ENI has operated in Iran for the past 50 years and invested roughly \$2.5 billion there. Among other investments, ENI has a 60 percent interest in the Darquain oilfield, from which it extracts and takes 9,000 barrels a day, with another 22,000 barrels a day expected when the field reaches full capacity in 2007.

Coal

¶13. (U) In 2004, coal was used to generate roughly seven percent of the electricity produced in Italy. Italy does not produce coal domestically, and must import the coal used to generate electricity. From January through November, 2005,

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Italy imported coal products worth 1.76 billion euros. Ranked by the value of coal exported to Italy, Italy's leading sources of coal were Indonesia (19 percent), South Africa (15 percent), the United States (13 percent), Australia (12 percent), Colombia (9 percent), Russia (6 percent), and China (4 percent). In 2004, the United States exported 2.1 million short tons of coal to Italy.

¶14. (U) According to the International Energy Agency's 2003 review of Italy's energy policies, the GOI expects coal will produce 22 percent of the country's electricity by 2010. Garribba is optimistic that power companies can overcome local opposition to coal-fired power plants by emphasizing the construction of energy-efficient plants, the conversion to coal of plants that would otherwise be closed, and the use of emissions-reducing technology.

Nuclear

¶15. (U) Italy does not generate electricity using nuclear power plants. A 1987 referendum had the practical effect of banning nuclear power generation in Italy. The four nuclear plants operating at the time were closed, and research into nuclear energy ceased. (See Ref E for a complete overview of Italy's nuclear energy policies.)

¶16. (U) Italian firms continue to pursue nuclear power production outside of Italy. In May 2005, the Italian electricity parastatal Enel signed an MOU with Electricite de France (EDF) in which Enel agreed to partner with EDF in the

development of the European Pressurized Reactor (EPR), a next-generation nuclear reactor. According to an Enel press release, the participation in the EPR project will "contribute to rebuilding Enel's expertise in nuclear technology." Enel owns 66 percent of Slovenske Elektrarne, the Slovakian nuclear power operator. Additionally, there have been press reports that Enel is considering participation in the construction of a nuclear power plant in Bulgaria.

GOI Policymakers and Private-Sector Actors

¶17. (U) Within the GOI, the Ministries of Productive Activities (MPA) and Finance share responsibility for energy policy decision-making. The MPA views energy issues from an industrial perspective, and generally views energy policy as a means through which Italy can increase its global competitiveness. Finance Ministry involvement is through the GOI's 30 percent interest in ENI and Enel, Italy's parastatal oil/gas and electrical companies. The Finance Ministry tends to view energy issues from the perspective of a shareholder seeking to maximize the value of his shares and dividends. In September 2005, Enel estimated it would pay 61 euro cents per share in dividends.

¶18. (U) The MPA and Ministry of Finance frequently deadlock over energy policy due to their different perspectives, according to Carlo Crea, General Secretary of Italy's Energy Authority. One example is the issue of liberalization, in which the MPA urged increasing competition in the energy sector to lower the price of energy in Italy and the cost of producing Italian goods. The Ministry of Finance opposed these efforts because of the negative effect liberalization would have on government revenues generated by Enel and ENI dividends. (See Ref D for a detailed analysis of liberalization in the Italian energy sector.)

¶19. (U) The Energy Authority is Italy's independent regulator of the energy sector, similar to the Federal Energy Regulatory Commission. Although the Authority's powers are limited, it is respected for the expertise of its staff, and plays a role in shaping the GOI's understanding of energy issues. It does not have a significant role in determining energy policy.

¶20. (U) In the private sector, Enel and ENI dominate the electricity and oil/gas sectors, respectively. The GOI holds a controlling interest in both companies and appoints key officers and members of the board. Although both companies are private and are listed on the Milan stock exchange, both have extremely close relations with the GOI, and it is almost

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inconceivable that either company would undertake a major shift in corporate strategy without consulting the GOI. Similarly, both corporate entities have a strong, informal influence on GOI energy policy making.

Liberalization Efforts

¶21. (U) Although the GOI has made efforts to liberalize the electricity sector, the consumer has yet to see the benefits of these efforts because of the dominant positions retained by ENI and Enel, the former monopolies. At 0.09 dollars per kilowatt hour for industrial users and 0.15 dollars per kilowatt hour for residential users, electricity prices in Italy are the highest in Europe, according to The Economist.

¶22. (U) Enel, the former monopolist now 30 percent-owned by the GOI, dominates the electricity sector, although smaller companies compete in some markets. According to the Energy Authority, Enel produces 49.2 percent of Italy's

electricity. Other electricity companies include Edison, which generates 12.3 percent of Italy's electricity, Edipower (7.6 percent), and Endesa Italia (6.3 percent).

¶23. (U) ENI, a parastatal 30 percent-owned by the GOI, dominates the oil and gas industry. ENI owns 100 percent of Italy's only operating re-gasification facility, 50 percent of Snam, the company which operates oil and gas pipelines within Italy, and 98 percent of Stoccaggi Gas Italia (Stogit), which runs Italy's natural gas storage facilities. Although there are projects underway which will compete with ENI when they are completed (see paragraphs 7-9, above) the time necessary to plan and build natural gas and oil infrastructure means that ENI will retain its dominant position for some time. ExxonMobil's Northern Adriatic regasification plant, for example, has been under development since the mid-1990s. Legal and administrative barriers have delayed completion of many regasification projects.

Winter 2005-2006: A Case In Point

¶24. (U) Italy experienced a natural gas shortage in January-March 2006(Ref A). Italy usually receives 2.1 billion cubic feet (60 million cubic meters) of natural gas daily from Russia. This winter, the coldest in 32 years, demand surged to 13.8 billion cubic feet on the coldest days. During the first two days of January, deliveries from Russia were down sixteen percent. For January, deliveries were down between six and eight percent (although deliveries in February were down about one percent). Italy made up the difference by tapping into its reserves and by cutting off natural gas deliveries to "preferred" commercial customers, who pay a lower price for gas in exchange for agreeing to delivery interruptions in emergency circumstances. According to Garribba, Italy's reserves may be depleted by winter's end (here in Italy, through end-March). "The system was used beyond its design," and "may not be able to handle a cold snap in March," Garribba said. (Comment: At the time of this writing, Italy is still suffering temperatures well below average. End comment.)

¶25. (U) Publicly, the GOI attributed the shortage of natural gas to countries along the pipeline from Russia taking more than their allotment (Ref B). Privately, GOI energy experts admit that shortages were also caused by shortcomings in Italy's infrastructure. According to Garribba, the shortage was caused by increased demand for natural gas for use in residential heating and power generation, coupled with a lack of investment in the infrastructure and facilities necessary for natural gas storage and transmission. Investment in these facilities, Garribba claims, would have allowed increased imports to ensure that Italy's natural gas reserves were sufficient to ride out momentary interruptions in supply.

¶26. (U) Carlo Crea, Secretary General of the Energy Authority, echoed Garribba's analysis, and noted that as Italy's dependence on natural gas has expanded, there has not been commensurate investment in infrastructure. In fact, Crea speculated recently that ENI slowed development of additional natural gas transmission facilities to exploit its dominant position in Italy's natural gas market, and said

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Italy's anti-trust authorities should investigate ENI's actions.

Italian Views of Energy Security

¶27. (U) Garribba noted the global demand for natural gas will continue to rise as countries seek cleaner sources of energy to comply with their Kyoto obligations, but said that the Achilles' heel of natural gas is the lack of reliable

supply. The problem is not Russia, he elaborated, but Italy's location on the natural gas pipeline from Russia to Western Europe. Specifically, Garribba noted that because it is at the end of the pipeline, Italy takes the hit when other countries take more than their gas allotment. In the case of this winter's decline in deliveries, Garribba said the decrease was not due to Russian malfeasance, but to siphoning-off in unspecified countries along the pipeline, which runs through politically unstable countries like the Ukraine, Moldova, and Romania. Garribba nonetheless empathized, and noted the Ukrainian economy is in dire straits and that the government had ceded its control of the pipeline to a private corporation.

¶28. (U) Garribba, in fact, views the Russians as honest suppliers. During this winter's gas shortage, and after a trip to Moscow by MPA Minister Scajola (to whom Garribba reports), Russia increased the amount of gas in the pipeline to ensure that Italy received its full allotment of gas to accommodate the alleged third-country siphoning-off. Garribba acknowledged that some GOI officials (including Foreign Minister Fini and MPA Minister Scajola) are not as sanguine as he is about Russia's reliability and are pressing for diversification of the countries from which Italy imports natural gas. (See Ref C for MPA Minister Scajola's views of EU energy dependency on Russia.)

¶29. (U) The solution, according to Garribba, is to build pipelines that by-pass countries which may take more than their share. Garribba cited the Turkey-Greece-Italy interconnector and the proposed Baltic underwater pipeline from Russia to Germany as ways to increase natural gas security. He said the GOI also views the interconnector as an additional means through which to draw Turkey closer to the EU.
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